IN THE SUPREME COURT OF MISSOURI

State of Missouri, ex rel, Sprint Missouri, Inc. Appellant,	)	
vs.	)	**Case No. SC 86584**
Public Service Commission of the State of Missouri, Respondent.	)	

APPEAL FROM THE CIRCUIT COURT OF COLE COUNTY, MISSOURI
HONORABLE RICHARD G. CALLAHAN, JUDGE, DIVISION II

SUBSTITUTE BRIEF OF INTERVENOR OFFICE OF THE PUBLIC COUNSEL OF MISSOURI AND APPENDIX

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JURISDICTIONAL STATEMENT

This case was transferred to this Court on March 1, 2005, pursuant to Mo. Rule Civ. Procedure 83.04. This case raises issues of general interest and importance. It involves the proper interpretation of Section 392.245.11, RSMo 2000, regarding the scope and extent that price cap regulated local exchange companies can exercise their pricing authority for almost all telecommunications services. It also involves the interrelationship of the Public Service Commission's long-standing statutory powers and duties under traditional regulation with its powers and duties under price cap regulation.

This is the first time that the price cap statute's pricing provisions have been reviewed since the enactment of Senate Bill 507 (LAWS, 1996) that established this new form of telecommunications regulation. As reflected in the purposes of telecommunications regulation enunciated in Section 392.185(6), RSMo 2000, pricing is the keystone of this regulation. It allows the incumbent local exchange company flexibility to price services, based not on cost of the services and the rate of return allowed the company on its investment (*See*, Section 392.240.1, RSMo), but rather based on competition and the marketplace. At the same time, Section 392.245.11, RSMo, also protects the ratepayers from extraordinary rate increases (sometimes referred to as "rate shock") by setting a cap on prices so that prices cannot increase more than 8% in a 12-month period.

This case is important and has general statewide interest because it effects millions of telephone customers, the operation of the state's largest local telephone

companies and, potentially, every incumbent telephone company and their customers. Sprint, SBC, CenturyTel, and Spectra d/b/a Centurytel are the four price cap regulated large companies that serve the three largest metropolitan areas and most of the state's local telephone exchanges with an estimated 3,140,000 total customer lines. Recently two small companies with a total of 72,000 customers have sought price cap treatment. Section 392.245.1 and .2, RSMo allows every incumbent local exchange company (former monopoly local telephone service providers) to qualify for price cap regulation in lieu of rate of return regulation if an alternative provider (competitor) is certified to operate and provides service in competition with the incumbent in the incumbent's service territory.

Two cases involving the pricing authority of price cap companies and the PSC's jurisdiction to review rate changes under Section 392.245.11, RSMo are now pending in the Court of Appeals, Western District. These cases are:

- *State of Missouri ex rel. Southwestern Bell Telephone, L.P., d/b/a SBC Missouri, Appellant, v. The Missouri Public Service Commission, Respondent, Office of the Public Counsel, Intervenor,* Case No. WD64502 (Submitted March 30, 2005)
- *State of Missouri ex rel. John B. Coffman, Public Counsel, Appellant/Relator, v. Public Service Commission of the State of Missouri, a state agency, et. al, Respondents, and Sprint Missouri, Inc. db/a Sprint and*

Southwestern Bell Telephone, L.P. d/b/a SBC Missouri, Intervenors, Case No. WD64737 (Argument scheduled May 31, 2005)

STATEMENT OF FACTS

Intervenor Public Counsel adopts the Statement of Facts of Respondent Public Service Commission of Missouri.

SCOPE OF REVIEW

Standard of Review Applicable to Points I and II

Both points I and II raised on appeal relate to the Missouri Public Service Commission's authority to review and reject a price cap regulated company's price changes for nonbasic telecommunications services under Section 392.245, RSMo 2000. Therefore, the Court's scope of review focuses on the whether or not the PSC's decision was lawful: (1) did the PSC have statutory authority to review Sprint's tariff and (2) did the PSC correctly interpret and apply Section 392.245.11, RSMo. when it rejected the tariff.

Mo. Const. (1945 as amended 1976), Article V, Section 18, provides for judicial review of all administrative agency decisions to determine if the decision is "authorized by law, and in cases in which a hearing is required by law, whether the same are supported by competent and substantial evidence upon the whole record." The circuit court reviews Public Service Commission decisions under Section 386.510, RSMo 2000, that defines the scope of that review as a determination of the lawfulness and reasonableness of the order appealed.

On appeal, the Court reviews the order or decision of the Commission, not the judgment of the circuit court. In that review, the Court does not give deference to the circuit court's determination. *State ex rel. Coffman, et al v. Missouri Public Service Commission*, 154 S.W.3d 316, 319-320 (Mo. App. W.D. 2004)

In *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 47 (Mo. banc 1979), the Court said the

standard of review was two-pronged: (1) to determine whether the Commission's order is lawful and (2) to determine whether it is reasonable and based on competent and substantial evidence upon the whole record. The lawfulness question turns on whether the PSC had the statutory authority to act as it did. When determining whether an order is lawful, the Court exercises unrestricted independent judgment and must correct the Commission's erroneous interpretations of the law. *State ex rel. Coffman v. PSC*, supra, 320; *State of Mo. ex rel. Associated Natural Gas Company v. Public Service Comm'n,* 37 S.W. 3d 287, 292 (Mo App. W.D. 2000). If there is some doubt or ambiguity as to the meaning of a statute, the Court may give consideration to the PSC's practical construction in its administration, but that construction is not binding. *State ex rel. Gulf Transport Company v. Public Service Commission of the State of Missouri*, 658 S.W.2d 448, 452 (Mo. App. W.D. 1983).

The second prong is to determine if the Commission's order is reasonable. Reasonableness depends on whether the decision is supported by competent and substantial evidence upon the whole record and on whether the order is arbitrary or capricious or is against the overwhelming weight of the evidence or whether the PSC abused its authority. *State ex rel. Chicago, Rock Island & Pacific Railroad Company v. Public Service Commission*, 312 S.W.2d 791, 796 (Mo. banc 1958); *State ex rel. Utility Consumers Council of Missouri, supra,* at 47. The Court reviews the record to assure that the Public Service Commission acted in accord with due process of law and that its findings and decisions do not run afoul of

constitutional and statutory requirements. *State ex rel. Chicago, Rock Island & Pacific Railroad Company*, *supra*, at 796

The burden is on Appellant to show that the PSC's decision was unlawful or unreasonable, and, therefore, must be reversed. Section 386.430, RSMo 2000; *Coffman*, supra.

POINTS AND AUTHORITIES RELIED UPON

I

THE PUBLIC SERVICE COMMISSION'S REJECTION OF SPRINT'S TARIFF TO INCREASE METROPOLITAN CALLING AREA PLAN RATES WAS LAWFUL AND REASONABLE BECAUSE THE COMMISSION HAS JURISDICTION TO REVIEW AND EITHER APPROVE OR REJECT TARIFFS PROPOSED BY PRICE CAP REGULATED COMPANIES IN THAT THE PSC HAS STATUTORY AUTHORITY PURSUANT TO SECTION 392.245.11, RSMO 2000 TO ENSURE THAT NONBASIC TELECOMMUNICATION SERVICE RATES ARE CONSISTENT WITH SECTION 392.200, RSMO 2000 MANDATING THAT ALL TELECOMMUNICATION RATES BE JUST, REASONABLE, NONDISCRIMINATORY, AND CONSISTENT WITH THE PUBLIC INTEREST AS EXPRESSED IN SECTION 392.185, RSMO 2000.

State v. Tustin, 322 S.W.2d 179, 182 (Mo. App. 1959)

Section 392.185, RSMo. 2000

Section 392.200.1 RSMo. 2000

Cases

Baldwin v. Director of Revenue, 38 S.W.3d 401, 405 (Mo. banc 2001)

Hagan v. Director of Revenue, 968 S.W.2d 704, 706 (Mo. banc 1998)

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State ex rel. Director of Revenue v. Gaertner, 32 S.W.3d 564, 566 (Mo. banc 2000)

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Section 392.361.5, RSMo 2000

Section 392.380.2, RSMo 2000

Section 392.390, RSMo 2000

Section 392.390(5), RSMo 2000

Section 392.470, RSMo. 2000

Section 392.470.1, RSMo 2000

Section 392.500, RSMo 2000

Other Authorities

In the Matter of the Petition of Southwestern Bell Telephone Company for a Determination that it is subject to Price Cap Regulation Under Section 392.245, RSMo Supp. 1996 (TO-97-397) 6 Mo.P.S.C.3d 493, 509 (September 16, 1997).

Senate Bill 507 (LAWS, 1996)

II

THE PUBLIC SERVICE COMMISSION'S REJECTION OF SPRINT'S TARIFF TO INCREASE METROPOLITAN CALLING AREA PLAN RATES WAS LAWFUL AND REASONABLE BECAUSE THE TARIFF PROPOSED RATE INCREASES THAT VIOLATED THE ANNUAL 8% PRICE CAP ALLOWED BY SECTION 392.245.11, RSMO 2000, FOR NONBASIC TELECOMMUNICATIONS SERVICES AND WAS INCONSISTENT WITH THE PURPOSE OF THE LAW IN THAT SPRINT PROPOSED TO INCREASE THESE RATES MORE THAN 8% IN ONE YEAR BY ATTEMPTING TO "BANK" OR ACCUMULATE AND COMPOUND THE ANNUAL 8% RATE INCREASE AUTHORITY THAT IT DID NOT EXERCISE IN PRIOR YEARS.

Section 392.245, RSMo. 2000

Section 392.245.11, RSMo. 2000

Section 392.200.5, RSMo. 2000

Statutes

Section 386.020(34), RSMo 2000

Section 392.185(5), RSMo 2000

Section 392.185(6), RSMo 2000

Section 392.245.3, RSMo 2000

Section 392.245.5, RSMo 2000

ARGUMENT I

THE PUBLIC SERVICE COMMISSION'S REJECTION OF SPRINT'S TARIFF TO INCREASE METROPOLITAN CALLING AREA PLAN RATES WAS LAWFUL AND REASONABLE BECAUSE THE COMMISSION HAS JURISDICTION TO REVIEW AND EITHER APPROVE OR REJECT TARIFFS PROPOSED BY PRICE CAP REGULATED COMPANIES IN THAT THE PSC HAS STATUTORY AUTHORITY PURSUANT TO SECTION 392.245.11, RSMO 2000 TO ENSURE THAT NONBASIC TELECOMMUNICATION SERVICE RATES ARE CONSISTENT WITH SECTION 392.200, RSMO 2000 MANDATING THAT ALL TELECOMMUNICATION RATES BE JUST, REASONABLE, NONDISCRIMINATORY, AND CONSISTENT WITH THE PUBLIC INTEREST AS EXPRESSED IN SECTION 392.185, RSMO 2000.

(RESPONDS TO APPELLANT'S POINT I)

Public Counsel asks the Court of affirm that the PSC acted lawfully in that there is statutory authority for the PSC to review and reject rate changes that violate the price cap statute. The PSC retains its long established authority to review and approve or disapprove proposed tariffs that change rates for telecommunications services even under the price cap form of regulation in Section 392.245, RSMo 2000. Proposed rates must be just and reasonable and not inconsistent with the public interest. Section 392.245.11; Sec. 392.200.1, Sec. 392.185 (6), RSMo 2000. Sprint's price cap status does not immunize it from the

PSC's jurisdiction to ensure that rates are just, reasonable and nondiscriminatory. The price cap statute specifically incorporates Section 392.200, RSMo 2000, as a condition for price cap rate changes. Section 392.200.1, RSMo imposes just and reasonable rate requirements for all telecommunications companies.

The 8% cap on increases in the maximum allowable rates for nonbasic services (such as the Metropolitan Calling Area rates) is not a grant of unbridled and unreviewable ratemaking authority for price cap companies. This cap is a 12-month ceiling for these rates designed to protect the ratepayer from rate shock and from excessive price increases when rates are not yet constrained and disciplined by effective competition with the incumbent local telephone company. *(See, State ex rel. Coffman v. PSC,* 154 S.W.3d 316, 320-323 (Mo App W.D. 2004), (SBC competition case) for a discussion of role of effective competition in price cap regulation.)

Sprint's Construction of Section 392.245.1, RSMo. is Erroneous.

Sprint argues that the Public Service Commission lacked authority to review and reject its tariff; (Appellant's Brief, Point I (p. 19-20; 24-28) Sprint claims that its classification as a price cap company in August, 1999 severed the PSC's authority to review Sprint's rates. Sprint points to the first sentence of Section 392.245.1, RSMo. and says that act of reclassification to price cap completed the PSC's future duty to ensure that Sprint's rates are just, reasonable, and lawful: "The commission shall have the authority to ensure that rates, charges,

tolls and rentals for telecommunications services are just, reasonable and lawful by employing price cap regulation." After the PSC "employed price cap regulation," the PSC fulfilled its mission with respect to Sprint's future price changes for price-capped services. In Sprint's mind, once it became a price cap company that status confers a just, reasonable and lawful imprimatur on all Sprint's ratemaking actions and tariffs. Price cap regulation, therefore, forecloses any PSC review of rate changes. Sprint's interpretation of the price cap statute is erroneous.

Sprint's Interpretation of Section 392.245.11 to Mandate Tariff Approval is Erroneous.

Sprint contends that by filing its rate change tariffs, the law demands that the PSC "shall" *approve* them within 30 days, without scrutiny by the PSC. (Sprint Brief, p. 25-26). This interpretation is unsound. It turns price cap ratemaking into an automated process with PSC approval a mere technical formality without substance.

This interpretation that all use of "shall" in a statute means mandatory action overlooks a recognized exception to that guide to statutory construction. When a statute provides a time period for a government official or a body to act, the act to be performed is not automatically mandatory, but may be directory. "A statute specifying a time within which a public officer is to perform an official act regarding the rights and duties of others is directory unless the nature of the act to be performed, or the phraseology of the statute, is such that the designation of time

must be considered a limitation of the power of the office." *St. Louis County v. State Tax Commission*, 529 S.W.2d 384, 386 (Mo. 1975).

A statute that requires that a special election for a council member shall be held "within sixty days after the adoption" was ruled directory. *State v. Felker*, 336 S.W.2d 419, 420 (Mo. App. S.D. 1960). The 30-day time period in the price cap statute seems designed to provide procedural uniformity and convenience in the process to avoid unnecessary delay in the Commission review and decision. It cannot be reasonably read to strip all authority and discretion from the PSC. If the tariff is not approved within 30 days, the statute does not make the tariff automatically effective nor does it prevent the PSC from suspending it beyond 30 days.

Sprint never clearly explains how the language of subsection one acts to nullify the mandate in Section 392.245.11, RSMo that price cap rate changes for nonbasic services are subject to Section 392.200, RSMo. Sprint chooses to ignore the Commission's order that reclassified Southwestern Bell Telephone as a price cap company:

> "Finally, the Commission stresses that the application of price cap regulation under Section 392.245.2 will not exempt a company so regulated from the jurisdiction and oversight of this Commission. Price cap regulation is a method of regulating the maximum *prices* charged by a company. See, Section 392.245.1. While it is true that a complaint based upon Section 390.240.1, RSMo 1994, which

> hinges on allegations of overearnings under the rate base/rate of return regulation, will no longer be cognizable, this Commission will retain its ability to appropriately regulate such companies and to entertain complaints other than Section 392.240.1."
>
> *In the Matter of the Petition of Southwestern Bell Telephone Company for a Determination that it is subject to Price Cap Regulation Under Section 392.245, RSMo Supp. 1996* (TO-97-397) 6 Mo.P.S.C.3d 493, 509 (September 16, 1997).

Section 392.245.1, RSMo provides specific statutory authorization for a form of regulation not previously permitted in Missouri. This subsection confers upon the PSC authority to "employ" price cap regulation as a means to regulate local telephone exchange companies as an alternative to the traditional rate of return regulation and provides the conditions under which it can employ this regulatory system. Subsequent subsections provide the process and structure for price cap regulation.

Subsection one is a grant of regulatory authority, not a limit on the PSC's regulatory power. (Compare subsection one's grant of authority with the express limitation on the PSC's use of its rate of return regulatory power in subsection seven.) It is not conclusive language that the adoption of price cap regulation in and of itself provides for just and reasonable rates. It does not ordain that all future rates proposed are presumed just and reasonable.

PSC's Jurisdiction to Regulate Rates for Price Cap Regulated Companies.

The General Assembly created the Public Service Commission in 1913 and delegated to it the legislature's authority to establish utility rates. *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951). The Commission's role and purpose is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity. *May Dep't Stores Co. v. Union Electric Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

The General Assembly did not intend for price cap regulation to terminate the historic role of the Public Service Commission as the arbitrator that balances the interests of the utility and the ratepayer and the public interest in the natural conflict between the telephone companies and the ratepayers over whether or not rates are just, reasonable, and lawful. Senate Bill 507 (Laws, 1996) recognized that the PSC continues to have a role in the new competitive environment and gave the PSC a new tool for regulation in the new era.

Section 392.245.11, RSMo. provides a specific link between price cap regulation and the PSC's general authority over telecommunications services and rates. That section governing pricing of nonbasic services provides that: "An incumbent local exchange telecommunications company may change the rates for its services, **consistent with the provisions of Section 392.200**, but not to exceed the maximum allowable prices, . . ."(emphasis added).

Section 392.200.1, RSMo. provides clear and unambiguous authority for the PSC to apply the just and reasonable standard to rates and the provision of

services. The remainder of Section 392.200, RSMo. provides that rates and services shall not be discriminatory.

The jurisdiction of the Commission over rates is clear. The PSC stands in the place of the state to protect ratepayers and to preserve the best interests of the public and otherwise carryout the intent and purpose of the telecommunications regulatory statutes defined by Section 392.185, RSMo 2000.

In telecommunications, the Commission's duty is to ensure that the telephone facilities provided by regulated providers are safe and adequate and that the rates are just and reasonable. Section 392.200.1, RSMo 2000. The Commission has general supervision over telephone companies under Section 386.230.1, RSMo 2000. In the exercise of this supervisory power, it can investigate any matter, including rates and adequacy of telecommunications services, and provide relief where warranted. Section 386.330.1 and .2; Section 392.200.1, RSMo.

The PSC's long-standing authority over telecommunications companies operating in Missouri was not terminated with the dawn of competition. Section 392.500, RSMo (enacted as part of H.B. 360, Laws, 1987) incorporated Section 392.200, RSMo as a condition for all proposed changes in rates for any competitive telecommunications service, as it adopted a new procedure for processing ratemaking tariffs. In Section 392.470.1, RSMo, "the commission may impose any condition or conditions that it deems reasonable and necessary upon any company providing telecommunications service if such conditions are in the

public interest and consistent with the provisions and purposes of this chapter," including providing for "just and reasonable" intercompany compensation for access to local networks.

Section 392.380.2 RSMo. provides with certain exceptions, that "the provisions of chapter 386, RSMo, and sections 392.010 to 392.360 are fully and equally applicable to competitive and transitionally competitive telecommunications services and to all telecommunications companies . . . ."

Section 392.361.5, RSMo. (adopted in H.B. 360 as part of the telecommunications law) recognized the changing nature of competition and authorized the Commission to suspend or modify the application of regulations and certain statutes to transitionally competitive or competitive services or companies, "except as provided in section 392.390." Section 392.390 (5), RSMo provides that all telecommunications companies shall at a minimum be subject to the provisions of section 392.200, subsections 2, 3, 4 and 5. In *State ex rel. Coffman v. PSC*, 150 S.W.3d 92, 102 (Mo App W.D. 2004) (IXC Surcharge cases), these provisions were viewed as granting the PSC discretion to review competitive long distance company rates for justness and reasonableness under Section 392.200.1 and mandating a review of these rates for discrimination under subsections 2,3,4, and 5.

As further evidence of the General Assembly's intent to include all telecommunications companies within the PSC's regulatory scope, Section

392.190, RSMo states: " The provisions of sections 392.190 to 392.530 shall apply to telecommunications service between one point and another within the state of Missouri and to every telecommunications company." Price cap companies are not excluded. The PSC can impose any conditions that it deems reasonable and necessary upon any company providing telecommunications service if those conditions are in the public interest and are consistent with the provisions and purposes of the chapter. Section 392.470, RSMo. Again, price cap companies are not exempted from the application of that section.

Senate Bill 507 Does Not Strip PSC of Power to Ensure Just, Reasonable and Lawful Rates.

With the enactment of Senate Bill 507, the regulatory scheme for telecommunications services provided by the local exchange companies was modified to provide for competition and to establish a transitional form of regulation between the traditional rate of return, monopoly regulation and a fully competitive environment.

Under Senate Bill 507, the PSC continued to have authority to act in the public interest. The Commission's continuing authority over telecommunications ratemaking can be found in the General Assembly's statement of its legislative purpose for telecommunications in Section 392.185, RSMo 2000. Section 392.185 (4), RSMo provides that one legislative purpose (and by extension one of the PSC's purposes) is to "ensure that customers pay only reasonable charges for

telecommunications service." Section 392.185 (6), RSMo allows "full and fair competition to function as a substitute for regulation when **consistent with the protection of ratepayers and otherwise consistent with the public interest**." (Emphasis supplied).

Section 392.185, RSMo 2000 is a vital piece of the regulatory scheme. It does not limit the PSC's authority over competitive or price cap companies, but rather guides the PSC in the exercise of its jurisdiction.

Section 392.245, RSMo must be Viewed in Context with Entire Regulatory System

The statutes governing the PSC and telecommunications regulation must be read *in pari materia* to give effect to the purposes of Section 392.245 in the overall regulatory scheme.

Sprint takes an unreasonably narrow view of the Commission's rate authority under Section 392.245, RSMo. such that it denies that the Commission has a right and a duty to review any increase in the rates for nonbasic services. Sprint's interpretation gives the companies an absolute right to increases without any review or oversight.

"Statutes relating to the same subject matter are considered *in pari materia*. *State ex. Rel Director of Revenue v. Gaertner*, 32 SW 3d 564, 566 (Mo banc 2000). Statutes relating to the same subject matter must be construed together even though they are found in different chapters or were enacted at different times.

The entire legislative act must be considered as one and all provisions must be harmonized if possible. *Hagan v. Director of Revenue*, 968 SW 2d 704, 706 (Mo banc 1998). Legislation must be read consistently and in harmony with all statutes of a related subject matter. *Baldwin v. Director of Revenue*, 38 SW 3d 401,405 (Mo banc 2001).

The courts look for the intention of the General Assembly, if possible, by faithfully giving the language of the act its plain and rational meaning if such can be done. Under this primary rule of construction, the court must "consider and give weight to the object sought to be accomplished, *the manifest purpose of the act*; and we avoid, if possible, any construction which will lead to absurd or unreasonable results." (Court's emphasis*)* *State v. Tustin,* 322 S.W.2d 179, 182 (Mo App 1959)

The manifest legislative purpose of price cap regulation to protect the ratepayer is defeated if the Commission is denied its review of increases in the maximum allowable prices of nonbasic services. If price cap companies can increase nonbasic services by 8% annually, then over a 3-year period the prices could be 24% higher; after 5 years, 40% higher. Here Sprint "banked" or accumulated these annual increases for 2 years, subjecting consumers to a 16% increase all at once. If this scenario is extended out for 5 years, consumers could be staggered with a 40% increase in one year, even in one month. This interpretation negates the manifest legislative purpose to cap rate increases on an annual basis of 8% to protect consumers.

The Commission must have the authority to act to protect the public. The only reasonable construction of the PSC's authority over price cap company pricing is to recognize that the legislature intended for the PSC to review price cap company tariffs to determine:

(a) if the rates proposed are just and reasonable, and nondiscriminatory (Section 392.200, RSMo);

(b) ensure that customers pay only reasonable charges for telecommunications service (Section 392.185(4));

(c) promote universally available and widely affordable telecommunications services (Section 392.185 (1), RSMo);

(d) allow full and fair competition to function as a substitute for regulation when consistent with the protection of ratepayers and otherwise consistent with the public interest (Section 392.185 (6), RSMo.

(e) that the rates proposed do not exceed the maximum allowable price permitted under Section 392.245, RSMo.

The Commission's review was within the Commission's statutory authority and its order rejecting the tariff that increased the rates for certain MCA services above 8% in a 12-month period was authorized by statute.

II

THE PUBLIC SERVICE COMMISSION'S REJECTION OF SPRINT'S TARIFF TO INCREASE METROPOLITAN CALLING AREA PLAN RATES WAS LAWFUL AND REASONABLE BECAUSE THE TARIFF PROPOSED RATE INCREASES THAT VIOLATED THE ANNUAL 8% PRICE CAP ALLOWED BY SECTION 392.245.11, RSMO 2000 FOR NONBASIC TELECOMMUNICATIONS SERVICES AND WAS INCONSISTENT WITH THE PURPOSE OF THE LAW IN THAT SPRINT PROPOSED TO INCREASE THESE RATES MORE THAN 8% IN ONE YEAR BY ATTEMPTING TO "BANK" OR ACCUMULATE AND COMPOUND THE ANNUAL 8% RATE INCREASE AUTHORITY THAT IT DID NOT EXERCISE IN PRIOR YEARS.

(Responds to Appellant's Point II)

The PSC acted lawfully and reasonably when it denied Sprint's imposition of rate increases to business and residential MCA customers in Tier 3 and 4 for a 12-month period of 13.4%, 16.6%, 16% and 16%. The decision preserved the specific legislative mandate that limits rate increases on an annual basis to 8% for a 12-month period. If the statute is interpreted as Sprint suggests, the outcome would render the 8% percentage annual cap on rate increase for nonbasic services meaningless.

Section 392.245.11, RSMo 2000, limits increases for the maximum allowable prices that a price cap company can charge for nonbasic

telecommunications services to 8% in a 12-month period; it does not allow a company to defer that 8% increase, in whole or in part, and carry over the unexercised increase authority to future years and then aggregate the deferred price increases to raise rates more than 8% in a 12-month period. Sprint's interpretation in Point II invalidates the consumer protection provided by the annual 8% price caps and is inconsistent with the intent and purpose of Section 392.245, RSMo. 2000.

In the two years before it filed the tariffs, Sprint attempted to create a legal distinction between the maximum allowable rate Sprint can charge for MCA service and the actual rate it charges the customers for MCA service. Sprint engaged in a fiction that established a tariff schedule of "phantom rates' without changing the actual rates charged to customers. It created a schedule of rates designated as "maximum allowable prices" and increased the "maximum allowable price" with the plan to implement these rates at some undefined time in the future. (L.F. 60-63; Brief p. 32).

Sprint's legal theory is that it can set theoretical rates called "maximum allowable prices" that are not in fact charged to customers that reserves its ability to recover the full measure of the revenues it could have achieved as if it had actually made the price increases in the 8% increments. If it does not activate its "phantom rates" and apply these increased rates now, it can "bank" these increased rates for future rate changes. (L.F. 63) Sprint's concept of the price cap

statute is that it can accumulate rate increase authority by 8% per year even if it declines to increase nonbasic service rates during a 12-month period.

After two years of no rate increases for a nonbasic service like MCA, Sprint claims an absolute right to increase rates by the full 8% for each year it had declined to raise rates, even if it results in a 16% immediate rate increase. Sprint looks at the 8% price cap for each year as an entitlement to a guaranteed 8% increase in revenues for its entire inventory of nonbasic telecommunications services. In Sprint's view, the unused 8% increase authority is just like money in the bank that can be accumulated year after year and then withdrawn in the future at Sprint's sole discretion. Sprint's argument suggests that the right to those revenues generated by the 8% in prices cannot be restricted or denied by the PSC.

The PSC properly rejected the MCA increases because they exceeded the express 8% limit on increases in Section 392.245.11, RSMo 2000. (L.F. 49-55). The PSC reasonably acted to enforce the clear mandate of the statute: price cap companies can only increase rates for nonbasic services by up to eight percent for each of the following twelve-month periods. They do this by providing notice to the Commission and filing tariffs establishing the rates for such services in such exchanges at such maximum allowable prices. Sprint's argument that it can establish by tariff a dual system of rates – maximum allowable prices that are not applied to ratepayers and actual rates charged ratepayers – has no authority in the statute, other law, or in logic.

Sprint's method of a dual schedule of rates was a device to enable Sprint to exceed that 8% limit and defeat the intent and purpose of the price cap statute. Under Sprint's plan it would in effect "bank" each year's 8% increase by reserving the unused increase through a schedule of maximum allowable prices. This "phantom" schedule of maximum rates is not applied to any ratepayers, but was a paper rate increase. The effective date for this schedule to become real ratepayer charges was not disclosed, but rather was held in abeyance until Sprint decided to activate it in the future. Through Sprint's plan, it could collect and accumulate years of unused 8% increases and then at one time, even in one month, spring increases on ratepayers far in excess of the 8% cap.

The PSC correctly prevented this evasion of the law. The Commission held that Sprint must use its annual increase authority by filing rates that go into effect and are applied to ratepayers or else it waives that authority for that year. (L.F. 155). It cannot defer these annual increases and bank them to some unspecified future time when it can then take years worth of 8% increases, and in a single 12-month period, exceed the annual statutory limit.

The PSC's interpretation is consistent with the goal of providing flexibility in setting rates. By filing tariffs without the time and cost of a rate case, it can change individual rates. Sprint can lower its rates as little or as much as it wants so long as the price is not less than the long-range incremental cost. (Section 392.200.5, RSMo) It can increase rates up to 8% or not at all. That is the flexibility provided by the price cap statute.

An even greater goal and intent of the price cap statute is to protect the ratepayer from rate increases under this system of reduced regulation of prices that removes the cost basis and rate of return factor from the ratemaking process. The PSC's rejection of the Sprint's scheme to bank rate increases preserved this fundamental purpose of the price cap statute.

Sprint's phantom rate schedule that purported to exercise its rate increase authority was ineffective to exercise that authority since the rates were never activated and were never actual rates charged; these were only "potential rates" which were not effective. The statute does not contemplate a series of phantom rate increases that floats along for years in some dormant state only to be levied in the amount and at the time set by the sole discretion of the company. Sprint's scheme defeats the rate increase and annual controls the legislature built into the statute.

Avoid Rate Shock

One of the purposes of a cap on prices in a flexible regulatory system such as that provided in Section 392.245, RSMo is provide a stopgap so that rates do not cause a hardship through large increases made in one year. Under Sprint's proposed increase of 13.4%, 16.6%, and 16%, customer rate shock is not only possible, but probable. Sprint proposed increased rates in one MCA tier 1 1/2 times the 8% cap in one MCA tier and doubled the 8% cap in another MCA tier.

Sprint views the 8% annual limit for increases as an entitlement that is bestowed upon the company that cannot be waived in whole or in part even if the company makes a business decision to keep rates unchanged or to raise rates at less than the cap for a year. The company makes a business decision to compete and, therefore, makes a choice: pursue (or retain) customers with lower prices or increase prices and risk the loss of customers and their purchases of a whole line of telecommunications services.

Price Reductions Are Recouped

Under Sprint's analysis, the company can increase rates to recoup all price reductions and all 8% price increases it did not take when prices were reduced. If a rate is reduced (e.g. by 2%), the next year the maximum allowable increase would be the restoration of the 2% reduction, the 8% increase applied to the restored price to calculate the maximum allowable price for year one, then an 8% increase applied to the year one maximum allowable price to produce the year two maximum allowable price. Sprint's interpretation wherein it recoups prior price reductions without the protection of the 8% annual cap limit defeats the legislative purposes in Section 392.185(5), RSMo that a customers pay only reasonable charges and Section 392.185(6), RSMo that makes protection of the ratepayer and the promotion of the public interest primary to considerations of competition substituting for regulation.

Flexibility in Regulation Goes Beyond Ability To Increase Prices

Price cap regulation is flexible regulation in that the company can select individual prices to increase, lower or remain unchanged, based upon competitive conditions or other business judgments and factors. The total cost of service and the rate of return on equity earned by the company is not considered by the PSC in approving the rates requested. The revenue requirement is not determined by an audit of expenses, but is a company decision based upon competitive and other business factors. The rate design does not require a total evaluation of the entire rate structure for services; the price cap company selects which services and which prices its will change or remain the same to produce its required revenue. This is the flexibility that Section 392.185(5) seeks, not just the ability to raise prices.

Sprint claims that it would be forced to increase all rates 8% to preserve its ability to retain its ability to take advantage of the 8% in the next year. This is speculation not supported in the record. This would require Sprint to ignore all competitive factors in pursuit of an 8% increase. It would nullify the legislature's expectation that competition would serve as a surrogate for regulation to control prices. Sprint would have to ignore all competitors and increase hundreds of prices for nonbasic services (all services other than basic local service and switched access per Section 386.020(34)) by 8% to preserve the full ability to increase rates above that maximum allowable price in the future. However, Sprint must make a business and competitive decision of which services it will seek to

raise and those which it will not and still be competitive and still produce the required revenues. When it makes that selection, it abandons other opportunities, that is, the ability to raise the maximum allowable price as the basis for future rate increases.

The PSC's interpretation gives effect to ratepayer protection goals and public interest considerations in Section 392.185(6) and employed in Section 392.245.11, RSMo in that the percentage limit on increases limits the ability of the company to increase prices at one time above a reasonable level (8%) and ensure that the company does not cause rate shock and overreach or gouge customers. The 8% increase in the maximum allowable price that can be charged in one year preserves the public interest and protects ratepayers by setting limits, but still provides a means for the company to reasonably raise its required revenue in one year without placing the burden on a particular service or group of services and the ratepayers that subscribe to those services.

Index Adjustments Does Not Include 8% Annual Increases

Sprint points to Section 392.245.5, RSMo as proof that its is entitled to carryover the 8% annual increase. (Brief, p. 35-36). However, Sprint overlooked the words "all index adjustments" in interpreting the effect of this subsection. When competition fails, the statute envisions that the PSC look to the "company's maximum allowable prices" at the time those prices "were first adjusted pursuant to subsection 4 or 11 of this section." For Sprint, a large ILEC, that would be "the

maximum allowable prices established for a company under subsection 1 of this section shall be those in effect on December thirty-first of the year preceding the year in which the company is first subject to regulation under this section." Section 392.245.3, RSMo.

The adjustments in subsection 11 for nonbasic services is a fixed percentage, not an "index adjustment" such as the Consumer Price Index-Telecommunication Services and Gross Domestic Product Price Index as used in subsection 4 (a) and (b). Subsection 5 should be interpreted in light of the specific requirement for the application of those specified "index adjustments which were or could have been filed from all proceeding years," and not the 8% authorized in subsection 11. In that light, subsection 5 provides no support for any legislative intent to carryover the 8%.

Sprint argues that customers are not harmed since Sprint could have increased the MCA rates 8% each year, but did not do so. Its two schedules of rates, one the actual rates charged, the other the schedule of silent rates it could charge, but will not make effective until some future, undesignated time are not benefits to the ratepayers. Sprint rationalizes that the increases falls within the “unused” or banked price increases for those services in those exchanges, so customers do not have grounds for complaint when Sprint finally claimed the increase it relinquished over the last two years. (L.F. 85-87; Brief p. 37). It is difficult to see how an extreme rate increase in one year to make up for the prior years is seen as a benefit to consumers.

Extending Sprint's reasoning to its logical conclusion, Sprint could increase its maximum allowable MCA rates by 8% per year for each of the first 5 years it is under price caps without increasing the rates charged. After the fifth year, it can increase actual rates by at least 40% over the charged MCA rates and still fall within the price cap maximum allowable price. This approach does violence to the intent and purpose of the regulatory plan and is inconsistent with the goal to provide customers with just, reasonable and affordable rates.

Sprint had the opportunity to generate additional revenues from increased MCA service prices by increasing rates each year. Sprint cannot recoup in one year the opportunities it relinquished to increase rates in 2000 and 2001. The customers properly reaped the benefit of Sprint's waiver of its opportunities.

The Commission properly applied Section 392.245.11, RSMo. 2000 and its rejection of the tariff was lawful and reasonable.

CONCLUSION

For the foregoing reasons, Intervenor Public Counsel asks the Court to affirm the Report and Order of the Missouri Public Service Commission as lawful and reasonable.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the above and foregoing document was sent via U.S. Mail, e-mail or hand delivered on the 11th day of April, 2005 to the following:

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CERTIFICATE PURSUANT TO RULE 84.06(c) AND 84.06(g)

I hereby certify that the foregoing Substitute Brief of Intervenor Office of the Public Counsel of Missouri complies with the limitations contained in Rule 84.06(b) and, according to the word count of the word-processing system used to prepare the Brief (excepting therefrom the cover, certificate of service, this certificate, and the signature block and the appendix), contains 7,718 words. I hereby further certify that the disk containing this Brief and submitted to the Court has been scanned for viruses and that the scan indicated that it is virus free.

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